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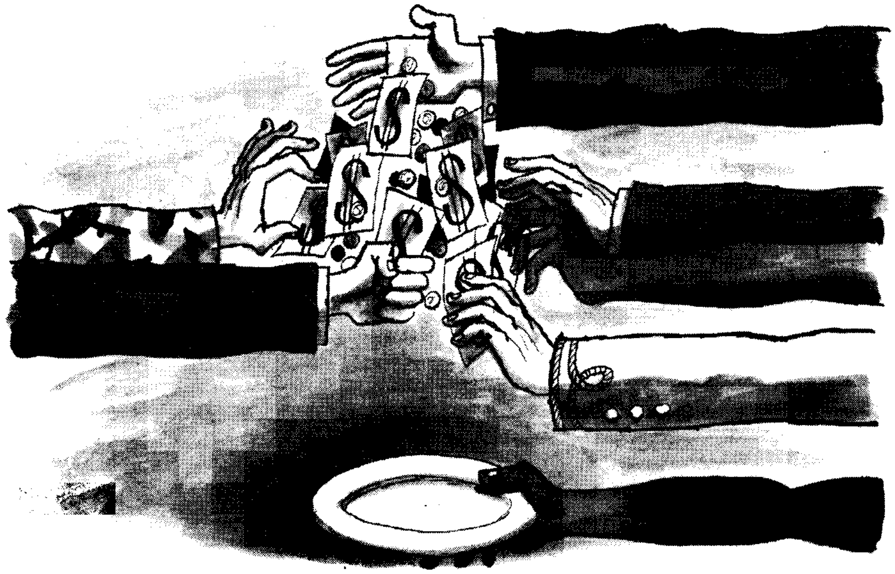


The kindness of strangers

The old jibe about aid—"poor people in rich countries helping rich people in poor countries"—has plenty of truth in it. Donors need to learn from past mistakes if they want to help poor countries grow

ANYBODY who tried to see the case for aid by looking merely at the way it is allotted would quickly give up in despair. The richest 40% of the developing world gets about twice as much per head as the poorest 40%. Big military spenders get about twice as much per head as do the less belligerent. El Salvador gets five times as much aid as Bangladesh, even though Bangladesh has 24 times as many people and is five times poorer than El Salvador.

Since 1960, about $1.4 trillion (in 1988 dollars) has been transferred in aid from rich countries to poor ones. Yet relatively little is known about what that process has achieved. Has it relieved poverty? Has it stimulated growth in the recipient countries? Has it helped the countries which give it? Such questions become more pressing as donor governments try harder to curb public spending. This year, two of the biggest players in the international aid business are looking afresh at their aims and priorities.

Brian Atwood, appointed by the Clinton administration to run America's Agency for International Development (AID), inherited an organisation encumbered over the years with 33 official goals by a Congress that loved using aid money to buy third-world adherence to its pet ideas. Now, faced with a sharp budget cut, Mr Atwood is trying to pare down to just four goals: building democracy, protecting the environment, fostering sustainable economic development and encouraging population control. Not, however, anything as basic as the relief of poverty.

A few blocks away from Mr Atwood's Washington office, the World Bank is going through a similar exercise. Set up in 1946, the Bank has become the most powerful of all the multilateral development organisations. But a critical internal report recently accused the Bank of caring more about pushing out loans than about monitoring how well the money was spent. Now the Bank hopes to improve the quality of its lending. It is also wondering about its future. Some of its past borrowers in East Asia are now rich enough to turn lenders themselves. More should follow. The Bank is trying to move into new areas, such as cleaning up the environment and setting up social-welfare systems. But some people wonder how long it will really be needed.

AID and the World Bank are unusual (although their critics rarely admit as much) in their openness and in the rigour with which they try to evaluate what they do. But other donors will also have to think about which kinds of aid to abandon as their budgets stop expanding. In the 1980s the official development assistance* (ODA) disbursed by members of the OECD's Development Assistance Committee (DAC)—21 rich countries plus the European Commission—increased by about a quarter in real terms; but between 1991 and 1992, the DAC's disbursements rose by just 0.5%. Development Initiatives, an independent British ginger group, believes "the end of an era" may have come; it reckons that aid budgets around the world are ceasing to grow at all. Almost the only exception is Japan, which provides a fifth of DAC aid and plans a substantial increase over the next five years.

Most multilateral donors, such as the UN agencies, also have budgets frozen. A rare exception is the European Development Fund, the aid arm of the European Union, which is taking a rapidly rising share of member-states' aid budgets. The EDF's secrecy and its mediocre reputation with recipient countries make some bilateral donors unhappy. "British officials are concerned about having to devote increasing quantities of their aid, which they regard as successful, to the European programme," reports Robert Cassen, a British aid expert.

Needed: a case for giving

Some developing countries—mainly the faster-growing ones perceived as "emerging markets"—have found the international capital markets to be increasingly willing suppliers of finance (see chart on next page). But demands for ODA are still appearing in new forms and from new sources. Astute third-world countries are giving old projects a green tinge to profit from fashionable enthusiasm for the environment. The countries of Eastern Europe and the former Soviet Union are competing with the third world for help. And the proportion of aid spent on relieving disasters has soared from 2% five years ago to around 7% today.

But with the clamour for more money goes increasing uncertainty about what aid is for and what it has achieved. The naive taxpayer might imagine that aid's main purpose was to relieve poverty. Yet only relatively small amounts of ODA go to the poorest of countries or to projects that benefit mainly the poorest of people. A study of America's aid programme conducted by the

* Defined as aid administered with the promotion of economic development and welfare as the main objective; concessional in character; and with a grant element of at least 25%.

Overseas Development Council (ODC), a Washington, DC, think-tank, found that more than $250 per person went to relatively high-income countries, but less than $1 per person to very low-income countries. Mahbub ul Haq of the United Nations Development Programme (UNDP), a fierce critic of aid's failure to reach the poorest, points out that the ten countries that are home to two-thirds of the world's poorest people receive only one-third of world aid.

Not helping the poor

Within poor countries, too, aid is rarely concentrated on the services that benefit the poorest. The World Bank reckons that, of all the aid going to low-income countries in 1988, a mere 2% went on primary health care and 1% on population programmes. Even the aid that is spent on health and education tends to go to services that benefit disproportionately the better-off. Aid for health care goes disproportionately to hospitals (in 1988-89, for instance, 33% of Japan's bilateral aid for health went on building hospitals); aid for education, to universities. In sub-Saharan Africa in the 1980s, only $1 of ODA went on each primary pupil; $11 on each secondary pupil; and $575 on each university student.

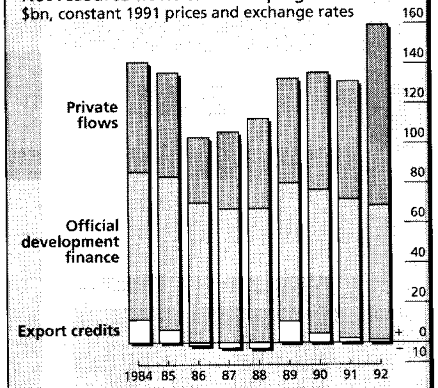
Such spending patterns often reflect the priorities of the recipient governments. Some donors have tried to persuade governments to distribute aid differently. They have had mixed success—not surprisingly, for their own motives in aid-giving often override the goal of poverty relief.

One such motive, powerful even since the end of the cold war, is the pursuit of national security. Most governments are coy about the role that national security plays in their aid budgets, but the biggest donor of all, the United States, is blatant: roughly a quarter of its $21 billion foreign-aid budget takes the form of military assistance, and roughly a quarter of the total budget goes to Israel and Egypt alone. "The United States has spent a lot less money on development than on advancing political and military goals," says John Sewell of the ODC. This year, America's aid budget protects the shares of Israel and Egypt. America also sees aid to Eastern Europe and to the countries of the former Soviet Union primarily in strategic terms.

"National security" is also now being used as an argument for giving more weight to all sorts of other goals in the drawing-up of aid budgets. Environmentalists claim that some types of environmental damage, such as global warming and the thinning of the ozone layer, may be worsened by poor-country growth, and they argue that rich-country aid donors should in their own interests take special care to minimise such risks. Others say aid should be used to parry the threats to rich countries posed by the trade in illegal drugs, by population growth and by third-world poverty.

More from the market

Net resource flows to developing countries
$bn, constant 1991 prices and exchange rates



Source: OECD

If the goal of national security can conflict with that of poverty relief, then the commercial interests of aid donors can do so even more. Japan's approach has at least the merit of simplicity: its development assistance goes mainly to countries that are most likely to become its future customers. All DAC countries tie some aid—the average is about a quarter—to the purchase of their own goods and services. One problem with tying is that it forces countries to pay over the odds for imports: on average, some estimates suggest, recipients pay 15% more than prevailing prices. Another is that it often distorts development priorities. It is easier to tie aid to a large item of capital spending, such as a dam, road or hospital, than to a small rural project that may do more good. Not surprisingly, tying is especially common in transport, power generation and telecommunications projects.

Aid recorded as tied has been falling as a proportion of bilateral ODA, according to the OECD, which monitors the practice. That may be partly because of the rise in spending on disaster relief. It may also reflect an international agreement on guidelines for tied aid. But governments are clever at finding ways to use aid to promote exports. It has, for example, taken two official investigations to uncover some of the links between British aid to Malaysia and British arms sales to that country.

Some kinds of ODA are given in the sure knowledge that the money will be spent mainly in the donor country, but without explicit tying. One example is technical assistance. Of the $12 billion or so which goes each year to buy advice, training and project design, over 90% is spent on foreign consultants. Half of all technical assistance goes to Africa—which, observes UNDP's Mr Haq, "has perhaps received more bad advice per capita than any other continent". Most thoughtful people in the aid business regard technical assistance as one of the least effective ways to foster development.

Stung by the claims of their aid lobbies that too little help goes to the poor, some governments are trying to steer more money through voluntary bodies, such as charities and church groups. Such bodies, known in the trade as non-governmental organisations or NGOs, have proliferated at astonishing speed in both the rich and poor worlds. The OECD counted 2,542 NGOs in its 24 member countries in 1990, compared with 1,603 in 1980. The growth in the south may have been faster still. Roger Riddell, of the Overseas Development Institute in London, who has made a special study of NGOs and development, talks of a "veritable explosion" in their numbers; he mentions 25,000 grassroots organisations in the Indian state of Tamil Nadu alone. The public and private money dispensed by NGOs amounted to 13% of total net ODA flows in 1990, and the share has been creeping up.

NGOs may be better than central governments at handling small projects and more sensitive to what local people really need. But even NGOs, according to Mr Riddell, usually fail to help the very poorest. "If government and official aid programmes fail to reach the bottom 20% of income groups, most NGO interventions probably miss the bottom 5-10%," he guesses. And, as more aid is channelled through NGOs, some groups may find it harder to retain the element of local participation which is their most obvious strength. More searching questions might be asked about whether they are efficiently run, or achieve their purported goals: a study of projects supported by the Ford Foundation in Africa in the late 1980s found "very few successes to talk about, especially in terms of post-intervention sustainability".

And what about growth?

When the modern panoply of official aid institutions grew up after the second world war, the intention was not to relieve poverty as such but to promote economic growth in poor countries. Aid was seen as a transitional device to help countries reach a point from which their economies would take off of their own accord. Its use was to remove shortages of capital and foreign exchange, boosting investment to a point at which growth could become self-sustaining.

In their baldest form, such views sit oddly beside the fact that, in many of the countries that have received the most aid and have the highest levels of capital investment, growth has been negligible. For at least 47 countries, aid represented more than 5% of GNP in 1988. Many of those countries were in sub-Saharan Africa, where GDP per head has been virtually flat for a quarter of a century. Yet, as David Lindauer and Michael Roemer of the Harvard Institute for International Development point out in a recent study, some of them were investing a share of GDP almost as large as that of much faster growing South-East Asian countries:

Cameroon, Côte d'Ivoire, Kenya, Tanzania and Zambia all invested at least 20% of GDP, a figure comparable with that for Indonesia or Thailand.

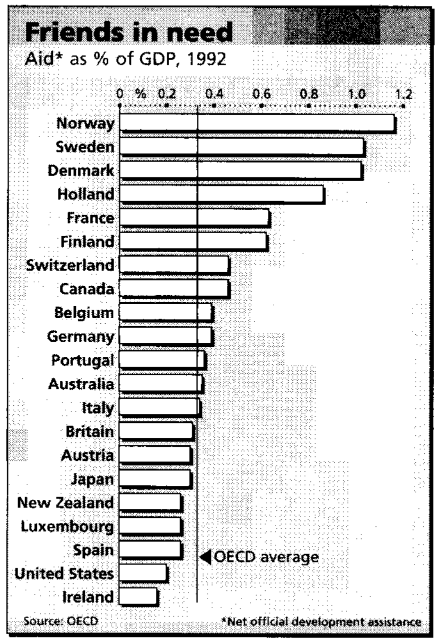
Such rough comparisons may prove little, but they draw attention to an awkward point. Some third-world countries have enjoyed fast economic growth with relatively little aid per head. In particular, some Asian success stories, such as China and Vietnam, had little or no aid at a time when donors were pouring money into Africa (although China is now the World Bank's largest single customer). If some countries can achieve economic growth with little aid, while other countries which get a great deal of aid do not grow at all, what if anything is aid good for?

One way to try to answer that question is to review the experience of individual countries and aid projects. In the late 1980s there were two valiant attempts to do just this: one conducted by a team led by Mr Cassen, the other on a more modest scale by Mr Riddell. Mr Cassen's team argued that "the majority of aid is successful in terms of its own objectives", but added that "a significant proportion does not succeed." Aid had worked badly in Africa; better in South Asia. Where aid did not work, the reason was sometimes that donors failed to learn from their mistakes or the mistakes of other donors; and sometimes that a recipient country failed to make the most of what was offered to it.

As for the impact of aid on economic growth, Mr Cassen concluded cautiously that one could not say that aid failed to help. In some countries, indeed, he found evidence that it did increase growth. Mr Riddell was similarly tentative. Aid, he concluded, "can assist in the alleviation of poverty, directly and indirectly" and "the available evidence ... fails to convince that, as a general rule, alternative strategies which exclude aid lead in theory or have led in practice to more rapid improvements in the living standards of the poor than have been achieved with aid."

These are hardly ringing endorsements. But these evaluations of individual aid programmes and projects are more positive in their findings than attempts to establish broader links between aid and growth, which have usually failed entirely. Plenty of economists have picked holes in the original idea that aid would boost investment: why should it, some ask, when governments may simply use income from aid as an excuse to spend tax revenues in other, less productive ways?

Other economists, such as Howard White of the Institute of Social Studies at The Hague, who has reviewed many of the economic studies of the effects of aid on growth, point to the difficulties of generalising. Given the various transfers that count as "aid", the many conditions that donors attach, the differing importance of aid in national economies and the complexity of economic growth, there are simply too many variables to say much that is useful.



Third-world Dutch disease

Since the start of the 1980s, many donors have come to believe that the quality of a country's economic management will do most to determine whether aid will do some good. Aid in the 1980s was frequently used, especially by the World Bank, as a prod to encourage countries to begin "structural adjustment" programmes. In some cases, the economic performance of these countries did improve—Ghana is one of the Bank's favourite examples. In other cases, it did not. A review by the IMF of 19 low-income countries which had undergone structural adjustment found that their current-account deficits averaged 12.3% of GDP before adjustment and 16.8% in the most recent year; and that their external debt had grown from 451% of exports to 482%.

Why was this? Were countries encouraged to adopt the wrong policies? Did they ignore the advice they were given? Or did the aid itself do some damage? Stefan de Vylder, a Swedish economist, argued for the last of these explanations at a conference in Stockholm in March. He argued that large volumes of aid (such as those associated with structural adjustment programmes) could damage an economy's international competitiveness; and countries where export performance was especially bad tended to be "rewarded" with low-interest loans and grants.

The damage to competitiveness, Mr de Vylder believes, is a version of "Dutch disease". This was the term coined in the 1970s to describe how Holland's exports of natural gas boosted its real exchange rate and thereby harmed its export competitiveness.

Mr White thinks something similar happened in Sri Lanka between 1974 and 1988, when a sharp increase in aid contributed to a divergence between the nominal and real exchange rates; this hurt the growth of the country's manufactured exports.

Mr de Vylder also worries about the tendency of aid to compensate for failure rather than to reward success. Bilateral donors have increasingly found that much of the aid they give to some countries goes towards paying back money unwisely lent by international financial institutions. Take Zambia as an example. Between 1974 and 1987, Zambia had entered into seven stand-by or structural agreements with the IMF—one every two years. Each was broken by the Zambian government. When, in 1987, Mr de Vylder visited Zambia to assess the latest bout of economic disaster, he asked a minister how seriously the government was worried at being lambasted by every aid donor. "Concerned?" mused the minister, seeming somewhat surprised. Then: "Oh no. They always come back." The minister was right, says Mr de Vylder. Shortly afterwards, the international financial institutions were again knocking on the door, asking for a new agreement.

It is easy, with aid, to find examples of individual projects that do some good. Most of those who criticise aid argue that if the quality were better—if donors tried harder to learn from each other's mistakes, if they were less keen to reap commercial gain, if they concentrated harder on meeting basic human needs—then there would be far fewer failures. All that is true; but—other things being equal—there would also be much less aid. Will poor countries do worse, over the next 30 years, if rich countries decline to give or lend them another \$1.4 trillion? At that price, the answer should be "Yes". Given the way that aid works at present, it is only "Maybe".